In the Supreme Court of the United Sta

OCTOBER TERM, 1972

No. 72-1539

KARL AND HILDA HOPE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. A18-A42) are reported at 55 T.C. 1020. The opinion of the court of appeals (Pet. App. A3-A14) is reported at 471 F. 2d 738.

JURISDICTION

The judgment of the court of appeals was entered on January 9, 1973, and a petition for rehearing by Karl and Hilda Hope was denied on February 14, 1973 (Pet. App. A15-A17). The petition for a writ of certiorari was filed on May 15, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether both courts below correctly held that petitioner's[1] sale of his shares of stock in Perfect Photo, Inc. was final in 1960, notwithstanding his unsuccessful attempt to rescind the sale in that year, and that the gain realized thereon was thus includible in his 1960 return.

STATUTES INVOLVED

The pertinent statutes are set forth in the Appendix to the petition (pp. A1-A2).

STATEMENT

Petitioner in 1960 sold his controlling interest (206,400 shares) in a corporation known as Perfect Photo, Inc. to Harriman Ripley and Company, Inc. In accordance with the conditions of the sale, Harriman Ripley, in turn, delivered an option to purchase 77,400 shares to petitioner's brother, Henry, and options to purchase 38,700 shares each to Sentiff and Grabb, employees of the corporation, all at the price sold by petitioner (Pet. App. A4-A6).

Petitioner became dissatisfied with the sale, and after unsuccessfully attempting to negotiate a rescission, instituted a suit on December 21, 1960, in the United States District Court for the Eastern District of Pennsylvania to rescind the sale of his stock. He alleged that Harriman Ripley, Sentiff and Grabb had conspired to defraud him (Pet. App. A6). The suit was settled on March 24, 1961. Under the terms of the settlement, petitioner paid $350,000.00 to Sentiff and Grabb as

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[1] "Petitioner" refers to Karl Hope. Hilda Hope is a party to this proceeding solely as the result of filing joint returns.

consideration for the assignment to him of their options to purchase a total of 77,400 shares of Perfect Photo from Harriman Ripley, and Henry Hope assigned to petitioner his option to purchase 77,400 shares of Perfect Photo without receiving any consideration. Consequently, on March 24, 1961, petitioner held options (which ran until December 31, 1961) to repurchase 75% of the stock he had sold to Harriman Ripley at the same price per share at which he had sold it. On December 29, 1961, he exercised the options, receiving the option stock in return for the agreed option price (Pet. App. A6-A7).[2]

Petitioner paid his attorney $85,000.00 in counsel fees for handling and settling the rescission suit and for effecting the delivery of the option stock (Pet. App. A8).

On his 1960 tax return, petitioner disclosed the July 27, 1960 transfer of 206,400 shares of Perfect Photo for $4,001,632, but he did not report any gain in that year from the sale on the ground that the transfer was not a completed sale in 1960. Instead, on his 1961 return, the 51,600 shares[3] of Perfect Photo retained by Harriman Ripley were treated as having been sold in that year and petitioner reported net proceeds from this sale of $651,578.00. The net proceeds figure was computed by reducing the $4,001,632.00 received in 1960 by (1) the $3,000,054.00 paid to Harriman Ripley

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[2] Following a sharp decline in the stock market in 1962, petitioner sold virtually all of the option stock during 1962 and 1963, suffering substantial losses on such sales. The resulting losses could not be carried back to prior years. Section 1212(b), Internal Revenue Code of 1954 (Pet. App. A8-A9).

[3] This figure reflects the difference between the 206,400 shares originally sold to Harriman Ripley in 1960 and the 154,800 shares repurchased by petitioner in 1961.

in December of 1961 on the exercise of the options and (2) the $350,000.00 paid to Sentiff and Grabb for the assignment of their options. Petitioner then computed his net gain on the sale by subtracting his original cost basis in the 51,600 shares, increased by the legal fee of $85,000, from the net proceeds realized (Pet. App. A8).

In his notice of deficiency for 1960, the Commissioner determined that there was a completed sale of the entire 206,400 shares of Perfect Photo in 1960, and that, therefore, the gain realized was taxable in that year. In the alternative, the Commissioner determined a deficiency for 1961, asserting that, if the sale was not final in 1960, taxpayer realized gain in 1961 on the sale of 51,600 shares of Perfect Photo in the amount of $986,098.00 (Pet. App. A8).

The Tax Court, in a reviewed decision, unanimously sustained the Commissioner's determination of a deficiency for 1960. It rejected the petitioner's contention that his tender of rescission in that year postponed realization of gain on the sale of his stock until 1961[4] (Pet. App. A31-A38). The Court of Appeals affirmed (Pet. App. A3-A14).

ARGUMENT

The decision below is correct. There is no conflict or any other reason for further review by this Court

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[4] Consistent with its decision that the entire proceeds from the sale were taxable in 1960, the Tax Court determined an overpayment of taxes with respect to 1961. The Commissioner filed a cross appeal from that determination solely to protect the revenue in the event the Court of Appeals reversed the Tax Court's decision with respect to 1960. Contemporaneously with this brief, the Commissioner is filing a protective cross petition for certiorari.

1. Petitioner acknowledges (Pet. 7) that, under the claim of right doctrine (*North American Oil Consolidated* v. *Burnet*, 286 U.S. 417) and principles of annual accounting for tax purposes (now embodied in Section 451(a) of the Internal Revenue Code of 1954 (Pet. App. A2)), funds which are received and held by a cash basis taxpayer under a claim of right are taxable in the year of receipt notwithstanding the taxpayer's repayment of those funds in a subsequent year. Nevertheless, he contends (Pet. 7-13) that both courts below erred in holding that the gain which he realized in 1960 on the sale of 206,400 shares of Perfect Photo stock was taxable in that year. This contention is based on the misconceived notion that his institution of a suit in the latter part of 1960 to rescind the sale of his stock postponed his obligation to report the gain on that sale until 1961 when the suit was settled. Petitioner reasons that the filing of that suit brought him within an exception to the claim of right doctrine that applies when, in the year of receipt, a taxpayer recognizes his liability to repay the amount received and makes provision for repayment.

As both the Tax Court and the Court of Appeals pointed out (Pet. App. A10-A12, A33-A34), however, petitioner was never under any obligation in 1960 to repay the proceeds from the sale of his Perfect Photo stock which he received on July 27, 1960. Indeed, if the market price of Perfect Photo had declined below $20.00 after the date of the sale, petitioner could, and no doubt would, have elected to retain the proceeds of the sale. The repayment of the funds received was entirely within his control. Under these circumstances, no basis exists for the application of an exception to the claim of right doctrine. See *Commissioner* v.

Brooklyn Union Gas Co., 62 F. 2d 505 (C.A. 2), affirmed, 22 B.T.A. 507.

2. Contrary to petitioner's assertion (Pet. 7-11), the decision of the court of appeals does not conflict with the decision in *Sohio Corp.* v. *Commissioner*, 163 F. 2d 590 (C.A. D.C.). In *Sohio*, the court held that an accrual basis taxpayer compelled by state law over its repeated protests to collect certain funds which it at no time asserted a right to retain, was not required to include those funds in its gross income. Here petitioner undisputedly asserted a claim of right (which was never disclaimed) over the sales proceeds from his stock at the time he received those proceeds and, therefore, was correctly required to include those proceeds in the year of receipt.

Petitioner also contends (Pet. 12-13) that the decision below conflicts with the claim of right doctrine as articulated by this Court in *Healy* v. *Commissioner*, 345 U.S. 278. The opinion in *Healy*, however, merely reaffirmed the holding in *North American Oil, supra*, that a taxpayer who receives funds under a claim of right and without restriction as to their disposition is required to take those funds into income in the year of receipt even though it may still be claimed that he is not entitled to retain them and even though he may ultimately be required to restore an equivalent amount. Here petitioner not only received the sales proceeds from his stock in 1960 under a claim of right and without any restriction as to their use, but also had complete control over the decision whether to seek a rescission of the sale. Thus the result reached by the court below is entirely consistent, and may even be deemed to follow *a fortiori*, from the decisions in *Healy* and *North American Oil*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
SCOTT P. CRAMPTON,
Assistant Attorney General.
ELMER J. KELSEY,
RICHARD FARBER,
Attorneys.

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